



DEPARTMENT OF
FINANCE

ARNOLD SCHWARZENEGGER, GOVERNOR

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December 28, 2005

Commissioner Michael L. Brown
Department of California Highway Patrol
2555 First Avenue
Sacramento, CA 95818

Dear Commissioner Brown:

Final Report: Department of California Highway Patrol—Internal Control Review

Enclosed is our final report on the Department of California Highway Patrol's (Department) internal control as of November 4, 2005. The Department of Finance, Office of State Audits and Evaluations (Finance), performed this review in accordance with the Financial Integrity and State Manager's Accountability Act of 1983, Government Code Section 13400 et seq.

In accordance with Finance's policy of increased transparency, the final report will be placed on the Finance website. We appreciate the assistance and cooperation of Department staff and management during our review. If you have any questions regarding this report, please contact Susan M. Botkin, Manager, or Brandon Nunes, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by Diana L. Ducay

Diana L. Ducay, Chief
Office of State Audits and Evaluations

Enclosure

cc: Mr. Kevin Green, Assistant Commissioner, Staff, Department of California Highway Patrol
Mr. Robert Giannoni, Chief, Personnel Management Division, Department of California Highway Patrol
Mr. Rick Vargas, Chief, Administrative Services Division, Department of California Highway Patrol
Mr. Scott MacGregor, Chief, Information Management Division, Department of California Highway Patrol
Mr. Fritz Eberly, Assistant Chief, Office of Internal Affairs, Department of California Highway Patrol
Lt. Renee DiFronzo, Office of Internal Affairs, Audit and Evaluation Unit, Department of California Highway Patrol

AN INTERNAL CONTROL REVIEW

Department of California Highway Patrol

Prepared By:
Office of State Audits and Evaluations
Department of Finance

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The Department of California Highway Patrol's (Department) mission is to ensure the safe, convenient, and efficient transportation of people and goods across the state's highway system and to provide the highest level of safety and security to the facilities and employees of the State of California. To accomplish this mission the Department patrols over 105,000 miles of state highways and county roads. To serve the needs of the mission, the Department operates over 200 facilities statewide, which include 8 field division offices, 6 communications centers, 18 dispatch centers, 102 area offices, 8 air operations, 37 resident posts, 16 commercial vehicle inspection facilities, 2 training academies, and various administrative facilities.

The Department management is responsible for the establishment and maintenance of internal and administrative controls. These controls are defined as a process to provide reasonable assurance regarding the achievement of objectives in the following categories: (a) reliability of financial reporting; (b) effectiveness and efficiency of operations; and (c) compliance with applicable laws and regulations. This definition includes five interrelated components:

- *Control environment* sets the tone of an organization, influencing the control consciousness of its staff. It is the foundation for all other internal control components, providing discipline and structure.
- *Risk assessment* is the entity's identification and analysis of relevant risks to achievement of its objectives, forming a basis for determining how the risks should be managed.
- *Control activities* are the policies and procedures that help ensure management directives are carried out.
- *Information and communication* are the identification, capture, and exchange of information in a form and time frame that enable staff to carry out their responsibilities.
- *Monitoring* is the process that assesses the quality of internal control performance over time.

The objective of our internal control review was to assist the Department in complying with the Financial Integrity and State Manager's Accountability Act of 1983. Specifically, we assisted the Department in determining whether: (1) assets are safeguarded from unauthorized use or disposition; (2) financial transactions are executed in accordance with management's authorizations and recorded properly to permit the preparation of reliable financial statements; and (3) financial operations are conducted in accordance with State Administrative Manual guidelines, and certain other state laws and regulations, as well as the Department's policies and procedures.

Our review did not include an evaluation of the efficiency or effectiveness of the Department's operations, or the accomplishment of program goals or objectives.

This report is intended for the information and use of the Department's management and should not be used for any other purpose. However, the report is a matter of public record and its distribution is not limited.

STAFF:

Susan M. Botkin, CGFM
Manager

Brandon Nunes,
Supervisor

Crystal Greenwell
Alexis Calleance
Mana Moarefparvar

EXECUTIVE SUMMARY

During our review of the Department of California Highway Patrol's (Department) internal control as of November 4, 2005, we identified areas where controls were in place and working as intended, and also identified areas where controls could be improved to reduce the risk of errors, irregularities, and material misstatements. Our findings and observations are summarized below. For further analysis refer to the Findings and Recommendations section of this report.

Information Technology: Internal control over information technology appears adequate. We found that access to accounting and fiscal software is adequately controlled, and data integrity is assured through processing controls and documentation. Review of written documentation for procedures ensures continuity of service and prevents the creation of a key person dependency.

Budgeting: Internal control over budgeting appears adequate. We determined procedures are in place to ensure that budget changes are properly approved, recorded and used for authorized purposes; and the final approved budget is recorded accurately and timely.

Cash Receipts: Internal control over cash receipts appears adequate but could be improved. We determined policies and procedures are in place to ensure collection, safeguarding, and depositing of cash receipts; separation of duties exist to ensure cash assets are adequately safeguarded; cash receipt transactions are correctly recorded in the accounting records and accountability is maintained; and subsidiary records are reconciled with control accounts and bank statements. However, we noted that the safeguarding of check deposits could be improved by ensuring checks are endorsed no later than the end of the working day of receipt. Further, we identified instances where cash receipts were not being deposited in a timely manner.

Receivables: Internal control over accounts receivable appears adequate but could be improved. Although receivables for reimbursable contracts and services are timely and accurately recorded in the accounting records, we found that accounts receivable related to current and former Department employees have been outstanding for long periods of time.

Purchasing: Internal controls over purchasing appear adequate. We determined that purchases are justified, reasonable, consistent with laws and regulations, and that the Department's assets are appropriately safeguarded when received. We found that policies and procedures are in place to control the purchase of goods and services including proper approvals, documentation and recording to the accounting records; payment of purchases is accurate and timely; and separation of duties are adequate.

Cash Disbursements: Internal controls over cash disbursements appear adequate but could be improved. We determined that policies and procedures are in place to ensure cash disbursements are authorized for appropriate purposes. In addition, cash disbursements journals, ledger accounts, and bank accounts are posted accurately, promptly, and periodically

reconciled. However improvements must be made to prevent managers from performing conflicting duties of manually signing checks and having access to blank check stock.

Revolving Fund: Internal controls over the revolving fund appear adequate. We determined policies and procedures are in place to ensure that revolving fund uses are authorized and made only for proper purposes, advances are adequate, and reimbursements and reconciliations are accurate and timely.

Personnel: Internal control over personnel and payroll functions appears adequate but could be improved. We found that policies and procedures are in place to ensure that personnel and payroll transactions are properly approved and certified by authorized personnel; payroll expenditures are recorded correctly, stay within budget, and are allocated to the correct fund and program; leave balances are accurate and adequately monitored; and employee appointments are proper and adequately supported. However, we noted that the documentation to support employee separation could be improved.

Contracts: Internal control over contracts appears adequate. We determined policies and procedures are in place to ensure contracts are approved by responsible persons and approvals are documented; contracts are accompanied by the required supporting documents and contain the required language; competitive bidding requirements are properly followed and contract splitting is avoided; contracts are monitored to ensure compliance with provisions; contract administration assures accomplishment of contracting objectives; and annual reports are completed timely.

Fixed Assets: Internal control over fixed assets appears adequate. We determined policies and procedures are in place to ensure proper safeguarding of assets; acquisitions and disposals are properly approved, documented, classified and recorded in the accounting records; monthly reconciliations of subsidiaries to general ledger accounts; and annual physical inventories are performed.

Financial Reporting: Internal control over financial reporting appears adequate. We determined that supervision over the compilation of financial statements and reports is adequate, financial statements are promptly and accurately prepared, year-end accounts payable represent authorized current obligations, and year-end accounts payable and encumbrance balances reported are valid and adequately disclosed.

This report is intended to assist the Department's management in focusing attention on areas of deficiency, strengthening internal control, and improving operations.



AUDITOR'S REPORT

Commissioner Michael L. Brown
Department of California Highway Patrol
2555 First Avenue
Sacramento, CA 95818

We have reviewed the Department of California Highway Patrol's (Department) internal control as of November 4, 2005, for conformity with Government Code Section 13400 et seq. Our review included obtaining an understanding of the internal control through observations and interviews, testing and evaluating the design and operating effectiveness of the internal control, and performing other procedures we considered necessary.

The Department's management is responsible for establishing and maintaining adequate internal control. This responsibility, in accordance with Government Code Section 13400 et seq., includes documenting internal control, communicating requirements to employees, and assuring that the internal control is functioning as prescribed. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of internal control are to provide reasonable, but not absolute, assurance that:

- Assets are safeguarded against loss from unauthorized use or disposition.
- Transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of reliable financial statements.
- Financial operations are conducted in accordance with policies and procedures established in the State Administrative Manual.

Because of inherent limitations in internal control, misstatements due to error or fraud may occur and not be detected. Also, projection of any evaluation of internal control to future periods is subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

In reviewing the Department's internal control as of November 4, 2005, we noted certain matters involving the internal control and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Department's ability to record, process, summarize, and

report financial data consistent with the assertions of management in the financial statements. A material weakness is a condition that precludes the Department's internal control from providing reasonable assurance that material misstatements in the financial statements will be prevented or detected on a timely basis. We believe that none of the reportable conditions are a material weakness. The reportable conditions are described in the *Findings and Recommendations* section of this report.

This report is intended solely for the information and use of the Department's management and is not intended to be and should not be used by anyone other than the specified party. However, this report is a matter of public record and its distribution is not limited.

Original signed by Diana L. Ducay

Diana L. Ducay, Chief
Office of State Audits and Evaluations

November 4, 2005

FINDINGS AND RECOMMENDATIONS

We reviewed accounting and administrative controls at the Department of California Highway Patrol (Department) as of November 4, 2005. During our review, we noted that many controls were functioning as intended. However, we also identified areas where controls are either not in place or functioning as intended, and where corrective action is necessary.

Cash Receipts

Effective internal controls over cash receipts are necessary to ensure that all amounts are properly safeguarded, collected, deposited, and remitted. We identified the following weaknesses in the Department's internal control over the cash receipts process.

FINDING 1 Endorsement of Checks

- Condition: Checks received by the Department are not restrictively endorsed immediately upon receipt. Specifically, cash receipts received each day are sorted for distribution and the accuracy of the distributed cash receipts is verified. The sorting process delays check endorsement from occurring on the day of receipt.
- Criteria: State Administrative Manual (SAM) Section 8023 requires all checks, money orders, and warrants received for deposit be restrictively endorsed for deposit as soon as possible after receipt, but no later than the end of the working day.
- Recommendation: Endorse receipts no later than the end of the working day.

FINDING 2 Untimely Cash Receipts Deposits

- Condition: The Department's field offices forward payments received for reimbursable agreements to headquarters for deposit. Our testing of these receipts identified 8 of 10 (80 percent) items tested were held anywhere from 11 to 33 days before being deposited. Not making deposits in a timely fashion could result in lost interest.
- Criteria: SAM Section 8032.1 states that agencies that have safes adequate to safeguard cash will accumulate collections until they amount to \$1,000 in cash or \$10,000 in cash, checks, money orders, and warrants (excluding state warrants and state checks), whichever occurs first. However, accumulated receipts of any amount will not remain undeposited for more than 10 working days.
- Recommendation: Deposit cash receipts in a timely fashion.

Accounts Receivable

Effective internal control over the accounts receivable process is necessary to ensure that controls are established for amounts due, amounts are billed timely, and adequate collection efforts are made on outstanding receivables. We observed the following weaknesses in the Department's internal control over receivables.

FINDING 3 Outstanding Accounts Receivable

Condition: The Department does not perform write-offs of outstanding accounts receivable, causing an overstatement of the account. We identified accounts receivable that were owed to the Department by current or former employees. As of June 30, 2005, \$401,251 of the \$664,610 (61 percent) accounts receivable balance was outstanding in excess of 120 days. Furthermore, of the employees we reviewed, three employees accounts receivable remained outstanding anywhere from 75 days to over 3 years. While the Department makes adequate attempts to collect the amounts due, not writing off accounts receivable once they are deemed uncollectible causes the account to be overstated.

Criteria: SAM Section 8776.6 allows departments to request a discharge from accountability if all reasonable collection procedures do not result in payment.

Government Code Section 19838 (a) details the reimbursement methods available to the state when an overpayment has been made to an employee.

Government Code Section 19838 (b) allows money owed to an employee who is separated from employment to be offset against any amount owed by that employee to the state.

Recommendation: Perform reviews of outstanding accounts receivable balances on a regular basis. When deemed uncollectible, execute write-off procedures to accurately reflect accounts receivable balances.

Cash Disbursements

Effective internal control over the cash disbursement process is necessary to ensure that controls are adequate to safeguard cash, and to prevent and timely detect any errors or irregularities. We identified the following weakness in the Department's internal control over cash disbursements.

FINDING 4 Lack of Separation of Duties

Condition: An Accounting Administrator II and Accounting Administrator III in the Fiscal Management section are authorized to manually sign checks and have access to blank check stock. Inadequate separation of duties increases the risk of loss or theft of the state's assets.

Criteria: Government Code 13403 states that the elements of a satisfactory system of internal accounting and administrative controls includes, but is not limited to, a plan of organization that provides segregation of duties appropriate for proper safeguarding of state assets.

SAM Section 8080 states that no one person will compare machine-signed checks with authorizations and supporting documents (or sign checks manually) and also have access to or control blank check stock.

Recommendation: Ensure that employees who are authorized to manually sign checks do not also have access to the blank check stock.

Payroll and Personnel

Effective internal control over the personnel and payroll functions is required to ensure that Department staff are properly appointed, have not separated with outstanding advances or in possession of Department assets, and payroll information is processed accurately and timely. We noted the following weakness in the controls over personnel and payroll.

FINDING 5 Inadequate Documentation of Employee Separations

Condition: For 5 of 10 (50 percent) employee separations tested, we determined that an employee separation checklist was not included in the personnel file. Without proper documentation supporting employee separations, it is difficult to ensure that the separated employee returned state assets such as computers, cell phones and access cards.

Criteria: SAM Section 20050 states that the elements of a satisfactory system of internal accounting and administrative controls include a system of authorization and record keeping procedures adequate to provide effective accounting control over assets, liabilities, revenues and expenditures.

Recommendation: Ensure an employee separation checklist is prepared and included in the personnel file.

CONCLUSION

Our review of the Department of California Highway Patrol's (Department) internal control presents opportunities for the Department's management to correct identified weaknesses and improve its operations. We believe internal controls would be strengthened and the Department would operate more efficiently and effectively if management implements our recommendations. The internal control weaknesses, if left uncorrected, increase the risk that material errors or irregularities could occur and remain undetected and could affect the accuracy of the Department's financial statements.

The findings in this report are based on fieldwork performed between August 22, 2005 and November 4, 2005. We presented these findings to the related divisions and units at the completion of each cycle and at the exit conference held on December 6, 2005.

DEPARTMENT'S RESPONSE

DEPARTMENT OF CALIFORNIA HIGHWAY PATROL

P.O. Box 942898
Sacramento, CA 94298-0001
(916) 657-7152
(800) 735-2929 (TT/TDD)
(800) 735-2922 (Voice)



December 21, 2005

File No.: 1.13003.4.FISMA

Ms. Diana L. Ducay, Chief
Office of State Audits and Evaluations
California Department of Finance
915 L Street
Sacramento, CA 95814

Dear Chief Ducay:

Enclosed is the California Highway Patrol's (CHP) response to the draft report on the CHP internal control audit performed under Interagency Agreement Number 5C004001-0. The CHP has agreed with all findings and as you will note from our response, many improvements are already in process based on your recommendations.

Thank you for allowing the CHP the opportunity to review and comment on the draft report. If you have any questions about our response, please contact Assistant Chief Fritz Eberly, Office of Internal Affairs, at (916) 657-7241.

Sincerely,

Original signed by M. L. Brown

M. L. BROWN
Commissioner

Enclosure

cc: Susan M. Botkin, Manager
Office of State Audits and Evaluations
Department of Finance

CHP Response to the Department of Finance Internal Control Review

Cash Receipts

FINDING 1 Endorsement of Checks

Condition: Checks received by the Department are not restrictively endorsed immediately upon receipt. Specifically, cash receipts received each day are sorted for distribution and the accuracy of the distributed cash receipts is verified. The sorting process delays check endorsement from occurring on the day of receipt.

Criteria: State Administrative Manual (SAM) Section 8023 requires all checks, money orders, and warrants received for deposit be restrictively endorsed for deposit as soon as possible after receipt, but no later than the end of the working day.

Recommendation: Endorse receipts no later than the end of the working day.

CHP Response:

The CHP agrees with the finding. It is the Department's written policy in accordance with the Highway Patrol Manual (HPM) 11.1, Chapter 4, that commanders are responsible for ensuring checks/money orders accepted for payment are signed and otherwise drawn in the proper format before being submitted along with the weekly transmittal. Notification was disseminated to all commands on October 24, 2005, of the importance in maintaining compliance with the HPM's policy and procedures.

FINDING 2 Untimely Cash Receipts Deposits

Condition: The Department's field offices forward payments received for reimbursable agreements to headquarters for deposit. Our testing of these receipts identified 8 of 10 (80 percent) items tested were held anywhere from 11 to 33 days before being deposited. Not making deposits in a timely fashion could result in lost interest.

Criteria: SAM Section 8032.1 states that agencies that have safes adequate to safeguard cash will accumulate collections until they amount to \$1,000 in cash or \$10,000 in cash, checks, money orders, and warrants (excluding state warrants and state checks), whichever occurs first. However, accumulated receipts of any amount will not remain undeposited for more than 10 working days.

Recommendation: Deposit cash receipts in a timely fashion.

CHP Response to the Department of Finance Internal Control Review

CHP Response:

The CHP agrees with the finding. It is the Department's written policy in accordance with HPM 11.1, Chapter 4, that advance deposits received for witness fees or movie, wide load, or special event details are to be submitted to the Cashiering Unit with each weekly transmittal. Notification was disseminated to all commands on October 24, 2005, of the importance in maintaining compliance with the HPM's policy and procedures.

Accounts Receivable

FINDING 3 Outstanding Accounts Receivable

Condition: The Department does not perform write-offs of outstanding accounts receivable, causing an overstatement of the account. We identified accounts receivable that were owed to the Department by current or former employees. As of June 30, 2005, \$401,251 of the \$664,610 (61 percent) accounts receivable balance was outstanding in excess of 120 days. Furthermore, of the employees we reviewed, three employees accounts receivable remained outstanding anywhere from 75 days to over 3 years. While the Department makes adequate attempts to collect the amounts due, not writing off accounts receivable once they are deemed uncollectible causes the account to be overstated.

Criteria: SAM Section 8776.6 allows departments to request a discharge from accountability if all reasonable collection procedures do not result in payment.

Government Code Section 19838 (a) details the reimbursement methods available to the state when an overpayment has been made to an employee.

Government Code Section 19838 (b) allows money owed to an employee who is separated from employment to be offset against any amount owed by that employee to the state.

Recommendation: Perform reviews of outstanding accounts receivable balances on a regular basis. When deemed uncollectible, execute write-off procedures to accurately reflect accounts receivable balances.

CHP Response:

The CHP agrees with the finding. Fiscal Management Section (FMS) and Personnel Services Section (PSS) have met to discuss the review process. Fiscal Management Section will provide a detailed listing of all open accounts receivables reflected in the accounting system to PSS. Personnel Services Section will research each open account, make a notation on the listing of the

CHP Response to the Department of Finance Internal Control Review

circumstances, and provide direction to FMS via a Register Instruction to Accounting (RITA).

Cash Disbursements

FINDING 4 Lack of Separation of Duties

Condition: An Accounting Administrator II and Accounting Administrator III in the Fiscal Management section are authorized to manually sign checks and have access to blank check stock. Inadequate separation of duties increases the risk of loss or theft of the states' assets.

Criteria: Government Code 13403 states the elements of a satisfactory system of internal accounting and administrative controls includes, but is not limited to, a plan of organization that provides segregation of duties appropriate for proper safeguarding of state assets.

SAM Section 8080 states that no one person will compare machine-signed checks with authorizations and supporting documents (or sign checks manually) and also have access to or control blank check stock.

Recommendation: Ensure employees who are authorized to manually sign checks do not also have access to the blank check stock.

CHP Response:

The CHP agrees with the finding. Although the Department is not in total compliance with SAM Section 8080, which states that no one person will compare machine-signed checks with authorizations and supporting documents (or sign checks manually) and also have access to or control blank check stock, the Department feels this finding to be a minimal risk. The Department conducts several reconciliations which verify check numbers for usage and validate counts with the check signing machine. In addition, in emergency situations it is imperative that management staff have access to blank check stock and be able to manually sign a check.

Payroll and Personnel

FINDING 5 Inadequate Documentation of Employee Separations

Condition: For 5 of 10 (50 percent) employee separations tested, we determined that an employee separation checklist was not included in the personnel file. Without proper documentation supporting employee separations, it is difficult to ensure that the separated employee returned state assets such as computers, cell phones and access cards.

CHP Response to the Department of Finance Internal Control Review

Criteria: SAM Section 20050 states that the elements of a satisfactory system of internal accounting and administrative controls include a system of authorization and record keeping procedures adequate to provide effective accounting control over assets, liabilities, revenues and expenditures.

Recommendation: Ensure an employee separation checklist is prepared and included in the personnel file.

CHP Response:

The CHP agrees with the finding. Personnel Services Section (PSS) will implement the necessary procedures by advising the Personnel Specialists to include the checklist in the separation packages, and informing Business Services Section, Personnel Files Unit, of this new procedure. This will be accomplished by January 2, 2006.